Joint Energy Commission and Air Resources Board Committee Hearing on a California Strategy to Reduce Petroleum Dependence
June 6, 2003

Testimony of
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I am pleased to offer the following comments on the draft report entitled *Reducing California's Petroleum Dependence*.

First, let me commend the staff of both the Commission and the Board on **the breadth and the depth of their analysis**:

- breadth, in that they placed within a single analytical framework a great range of actions, and
- depth, in that that analytic framework encompassed both environmental and non-environmental costs and benefits, while presenting impacts to the consumer and to the society as a whole.

I am particularly pleased that the analysis incorporates climate change associated with greenhouse gas emissions. While reasonable people can disagree about the magnitude of the number used to quantify that cost, its place in the analysis represents an important advance in policy analysis.

I'm certain that other states will look to California's analysis as a basis for their deliberations.

I encourage both **the Board and the Commission to adopt the analytical framework created as part of this study as an important legacy of this effort**. I'm certain that in the future we will be interested in assessing the performance of additional actions not analyzed within the context of this particular report. The maintenance of the tools employed in this study at both the Board and the Commission should make such future analysis more a matter of course and less a matter of extraordinary effort.

Second, I wish to re-emphasize the problems that petroleum dependence poses for our state, our nation and for our civilization. **The overwhelming dependence of the transportation sector on petroleum contributes the lion's share of the state's emission of greenhouse gases.** As the recent CEC inventory shows, transportation produces 59% of the emissions of the state. Gasoline alone contributes 36% - more than one-third of the entire state's GHG emissions - with diesel contributing an additional 8%.

The problem of petroleum dependence is not just environmental, but also economic. **A market that features tight supply, only a few suppliers and a growing reliance on imports bears a disturbing resemblance to the electricity market in California in 2001.** Price spikes during just a short period of time nearly overwhelmed our economy. Of course the petroleum fuels market differs in important ways from that of electricity, but nonetheless we need to learn from our recent experience. We should not delude ourselves into thinking that short-term but crippling events cannot happen in the petroleum sector simply because they haven't happened yet.

For this reason, I wish to **strike a cautionary note with respect to the benchmark prices for gasoline and diesel fuel used in the report**. The benchmarks are used to represent the cost of continuing to operate as we have. I do not doubt that the Energy Commission has an excellent historical basis for these benchmarks. But those average prices, even with their maximum long-term additional cost of a nickel per gallon attributable to volatility, may reflect the no-action costs no better than the long-term marginal cost of electricity reflects the true cost of the electricity crisis - price spikes, uncertainties, bankruptcies and turmoil - to the California economy. It is important therefore to note that some options which lead to losses under prices assumed in the report could easily turn in winners at average fuel prices not much higher than those used in the report and in fact lower than prices we have just recently experienced. I do not suggest that the Board and the Commission redo their analysis, though having the tools at hand would certainly facilitate such work in the future, but rather that they keep in mind the very large potential risk associated with dependence and recommend robust and implementable options even if the current analysis shows a low level of net cost with gasoline at $1.64/gal. Alternatives that we can implement but which generate losses at $1.64/gal of gasoline may be star performers when gasoline is $2 or $2.25/gal.

Third, I agree that **setting a goal of reducing petroleum use to15% less than 2003 by 2020 is laudable.** It appears to be technically and economically feasible, assuming the full range of options is available. It complements the Legislature's goal of deriving 20% of our electricity supply from renewable sources by 2017. It provides a benchmark for public and private programs. And it responds to the scientific consensus that global climate change is an issue that demands a response from all responsible parties

My concern with how we reach that goal leads me to my fourth comment. It is essential that **the Legislature receive complete information about the full range of options examined** by this effort. Specifically the report should present summary information about the overall costs and benefits of all three classes of options: fuel efficiency, alternative fuels and market mechanisms. While past efforts to institute market approaches to reducing air contaminants have met with limited political success their strong support from economists and policy experts justify providing information about options to the Legislature, which has the mandate to weigh their political feasibility.

Finally **I encourage the Board and the Commission to adopt recommendations for achieving the goal that depend less on the actions of others and more on actions that California, the world's fifth largest economy, can implement itself**. The report identifies fuel efficiency improvement as the predominant means by which the state will achieve its goals, with the preferred mechanism being revision of CAFE standards. There is no question that revision of CAFE standards would solve much of the problem of petroleum dependence. Similarly, prompt decisive action by FERC on price gouging would have averted much of our electricity crisis. Unfortunately we have learned that wishing for action by the federal government on California's behalf is a risky alternative. Prudence dictates that we take reasonable steps to chart our own destiny.

In this light I suggest the following approach, which I believe to be entirely consistent with the present course of the Board and the Commission:

a) First, **we need to keep the pressure on the federal government to revise CAFE standards**. Such revisions would help not only California but also the entire nation. I agree wholeheartedly with the Board and the Commission that revision of CAFÉ is the strategy of first choice.

b) Second, I suggest that the Board and the Commission recommend that the Legislature consider **a fallback strategy in the absence of progress on CAFE that consists of actions that California can implement independent of federal actions.** These actions should be based on the **best remaining options** examined by this report under both alternative fuels and market mechanisms. I define a "best option" as having both net positive direct benefits AND net positive consumer benefits, meaning both the society as a whole and consumers as a group are better off. I recognize that a fallback strategy may not fully achieve the goal but is nonetheless needed as a contingency.

c) With respect to alternative fuels I suggest that the Board and the Commission recommend that the Legislature consider **programs built on "best options" that could in mature market conditions and with potentially higher average fuel prices benefit CA producers and not just farmers in other states, and that do not worsen our GHG emissions**.

d) With respect to market mechanisms I suggest that the Board and Commission recommend that **as part of the fallback strategy the Legislature consider programs that provide benefits to both consumers and to society at large. Not all market mechanisms pass this test but some do, and therefore merit mention to the Legislature**. This report's analysis shows that one version of this approach, revenue neutral feebates to encourage the purchase of fuel efficient vehicles and spur technological innovation, shows both positive direct consumer benefits, meaning that even without considering environmental benefits, California consumers would be better off. In addition the potential reduction in petroleum dependence of such a program is of the same order of magnitude as reductions from the EEA fuel efficiency package and therefore, while not a replacement for revised CAFÉ standards, could contribute significantly to achieving the goal.

In conclusion, I want to stress that petroleum dependence is a serious problem, not only environmentally, but also economically over the medium and even the short term. As with other forms of dependence, solutions require a certain degree of soul-searching and commitment. And developing solutions is made doubly difficult in the public arena by the constant litany of diversions, misconstruals and occasional misrepresentations that dog this and any public policy debate of great import. By clarifying and strengthening the recommendations, this excellent report can make a major contribution to improving California's environment and economic health.

Thank you.